



December 11, 2008

Mr. Glenn Stober, Director  
California Business, Transportation, and Housing Agency  
980 Ninth Street, Suite 2450  
Sacramento, CA 95814

Dear Mr. Stober:

**Final Report—Pacific Coast Regional Small Business Development Corporation, Agreed-Upon Procedures**

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its agreed-upon procedures review of the Pacific Coast Regional Small Business Development Corporation's (Pacific Coast) compliance with the Small Business Loan Guarantee Program for the period July 1, 2006 through June 30, 2007.

The enclosed report is for your information and use. Pacific Coast's response to the report findings are incorporated into this final report. Pacific Coast agreed with our findings and we appreciate its willingness to implement corrective actions. The findings in our report are intended to assist management in improving the effectiveness and efficiency of its operations. In accordance with Finance's policy of increased transparency, the final report will be placed on the Finance website.

We appreciate the assistance and cooperation of Pacific Coast's staff during the review. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Rich Hebert, Supervisor, at (916) 322-2985.

Sincerely,

***Original signed by:***

David Botelho, Chief  
Office of State Audits and Evaluations

Enclosure

cc: Ms. Karen Kawada, Program Analyst, California Business, Transportation, and Housing Agency  
Mr. Mark J. Robertson, President, Pacific Coast Regional Small Business Development Corporation

# AGREED-UPON PROCEDURES

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Pacific Coast Regional Small Business  
Development Corporation

Small Business Loan Guarantee Program  
For the Period July 1, 2006  
through June 30, 2007

Prepared By:  
Office of State Audits and Evaluations  
Department of Finance

## **MEMBERS OF THE AUDIT TEAM**

Kimberly A. Tarvin, CPA  
Manager

Rich Hebert  
Supervisor

### **Staff**

Kweku Atta-Mensah  
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This report is also available on our website at <http://www.dof.ca.gov>

You can contact our office at:

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# INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

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Mr. Glenn Stober, Director  
California Business, Transportation, and Housing Agency  
980 Ninth Street, Suite 2450  
Sacramento, CA 95814

The Department of Finance, Office of State Audits and Evaluations (Finance), performed the procedures enumerated below, which were agreed to by the California Business, Transportation, and Housing Agency (BT&H) to assist in evaluating Pacific Coast Regional Small Business Development Corporation's (Pacific Coast) compliance with the Small Business Loan Guarantee Program (SBLGP). Pacific Coast management is responsible for compliance with these requirements. This review covers the period July 1, 2006 through June 30, 2007.

This agreed-upon procedures engagement was conducted in accordance with the *Statements on Standards for Attestation Engagements* published by the American Institute of Certified Public Accountants. These standards require that we report all findings from the application of the agreed-upon procedures. For findings that include questioned costs, materiality was defined as items with errors or omissions of \$1,000 or more. The sufficiency of these procedures is solely the responsibility of the BT&H. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

## Background

The SBLGP was created by the Legislature to encourage lenders to provide funds to small businesses and farming enterprises that need additional collateralization in the form of a loan guarantee. The loan guarantees provide the following:

- Encourage the development of small business opportunities for minority, women, and disabled persons.
- Alleviate unemployment.
- Allow participation in state public works contracts by small and emerging contractors.

The SBLGP was established within the California Technology, Trade, and Commerce Agency (CTTCA) and administered by the Office of Small Business Loan Guarantee Program. The CTTCA created a Loan Guarantee Trust Fund (Fund) to collateralize the guarantees on loans to small businesses made by local lending institutions. Under a contractual agreement with the

CTTCA, which was subsequently transferred to BT&H, program administration and direction of certain Fund account transactions were assigned to eleven regional financial development corporations. Each corporation issues guarantees on behalf of the state and manages its share of the Fund and portfolio of outstanding guarantees.

Pacific Coast was established in 1977 and is one of the eleven regional financial development corporations. Pacific Coast's mission is to deliver educational and financial services to small businesses most in need. During the period July 1, 2006 through June 30, 2007, Pacific Coast claimed \$863,000, which consists of \$125,000 for personnel costs and \$738,000 for loan guarantee fees.

## **Procedures Performed and Results**

### **1. Verification of Allowable Costs**

#### **a. Operational Expenses**

Pacific Coast claimed \$125,000 for reimbursement of operational costs. To determine whether the costs claimed were allowable as stipulated in the contract, we performed the following procedures:

- Reviewed the grant agreement to identify authorized positions and allowable salary rates.
- Verified personnel expenses claimed were supported by timesheets and paychecks, and that expenses claimed did not exceed the actual salaries paid.
- Analyzed the fringe benefits claimed to ensure that the percentage of personnel expenses charged to the program did not exceed the allowable rate.

Based on the procedures performed, the operational costs claimed were allowable, supported, and in compliance with the terms of the contract.

#### **b. Loan Guarantee Fees**

Pacific Coast claimed \$738,000 for loan guarantee fees based on 174 new loans issued at \$3,250 per loan and 75 in renewal loans at \$2,300 per loan. To verify that the loan guarantee fees claimed were allowable, we performed the following procedures:

- Identified the loan guarantees issued from the Monthly Loan Guarantee Registration Report.
- Reviewed a sample of borrower files and promissory notes to confirm the loan was made and determined whether it was a new loan or a renewal.
- Recalculated the variable fees to determine whether the loan guarantee fees were accurately claimed.

Based on the procedures performed, we determined that the loan guarantee fees were accurately claimed and allowable.

## 2. **Contracting Practices**

We verified that contracting practices were appropriate by determining whether related-party relationships existed with contractors. Specifically, we performed the following procedures:

- Interviewed Pacific Coast staff to gain an understanding of contracting practices.
- Reviewed the Statement of Economic Interest forms completed by Pacific Coast staff and officers.
- Determined whether any of Pacific Coast staff or officers reported any economic interest in any of the contractors.
- Reviewed the contract agreements and the general ledger to identify any transactions that indicate the existence of related-party relationships.

Based on the procedures performed, no related-party relationships were identified and we determined that Pacific Coast's contracting practices are appropriate.

## 3. **Cost Allocation**

To determine whether Pacific Coast's cost allocation plan methodology was reasonable and appropriately applied; we interviewed staff and reviewed financial records to identify other programs in addition to the SBLGP that would require allocation of costs between programs.

We determined that Pacific Coast's cost allocation methodology is reasonable and was appropriately applied.

## 4. **Record Maintenance**

To verify all required records are maintained, we performed the following:

- Interviewed Pacific Coast staff to obtain an understanding of the records maintained.
- Reviewed the general ledger, Loan Guarantee Program Database, Board of Directors and Loan Committee minutes, and loan portfolio records.

Overall, Pacific Coast maintained the required records. However, the Loan Guarantee Program Database has not been updated since 2000 for loan default recoveries. See Finding 2 in the Findings and Recommendations section of this report for further details.

## 5. **Collection Costs**

We interviewed staff and reviewed the general ledger and the Loan Guarantee Program Database to determine whether:

- Collection costs were charged correctly.
- Out-of-pocket costs were paid for each collection effort with the monies received by a single successful collection.

Based on the procedures performed, Pacific Coast did not charge collection costs and remitted the total default recovery amounts to the trustee without deducting any out-of-pocket costs for collection efforts.

## **6. Timely Deposit of Recovery Funds**

To determine the length of time between the receipt of recoveries and when funds are forwarded to the state or trustee for deposit, we interviewed staff and reviewed the Loan and Guarantee Program Database and the general ledger.

Based on the procedures performed, Pacific Coast appropriately forwarded recoveries from loan defaults. However, \$15,750 in loan recoveries were not remitted to the state or trustee within the required time period. See Finding 1 in the *Findings and Recommendations* section of the report for further details.

## **7. Accuracy and Reconciliation of Loan Guarantee Portfolio Records**

To determine whether the loan guarantee approval process is adequately documented and whether the portfolio records are accurate and reconcile with bank records, we performed the following procedures:

- Interviewed Pacific Coast staff to obtain an understanding of the loan guarantee approval process and records maintained.
- Reviewed a sample of loan guarantee files to evaluate the adequacy of the loan guarantee approval process documentation.
- Reviewed the Loan Guarantee Program Database to determine whether it was updated when an extension was granted to a matured line of credit.
- Determined whether the loan guarantee portfolio records were accurate and reconciled with bank records.

Pacific Coast receives periodic confirmation reports from lenders on the status of loans and performs a reconciliation with the Loan Guarantee Database. Any variance is resolved with the lender and reported to BT&H.

## **8. Monitoring of Collateral Holdings**

To determine whether Pacific Coast communicates the status of the collateral holdings and to identify Pacific Coast's monitoring efforts, we performed the following procedures:

- Interviewed Pacific Coast staff to identify communication and monitoring procedures.
- Reviewed lender confirmation reports to determine whether the information is reconciled to the Loan Guarantee Program Database.

Pacific Coast regularly communicates with the lenders, receives quarterly reports from the lenders for monitoring collateral holdings, and updates the Loan Guarantee Program Database accordingly.



## 9. Accounting Procedures

To determine whether Pacific Coast's accounting procedures are designed to prevent double billings and ensure the separation of duties are adequate, we performed the following procedures:

- Interviewed Pacific Coast staff regarding the accounting processes.
- Reviewed written cash receipts, accounts payables, and loan guarantee program invoice procedures.
- Reviewed the Pacific Coast organization chart.

Pacific Coast uses QuickBooks Pro 2007 to record the accounting transactions. The accounting procedures incorporate separation of duties and are adequately designed to prevent double billing.

## 10. Review of Independent Auditor's Report

We reviewed the single audit reports prepared by the Pacific Coast's Certified Public Accountant (CPA) for the fiscal periods ending June 30, 2006 and June 30, 2007 and the CPA's working papers to identify internal control weaknesses in the accounting procedures.

Our review of the audit reports and working papers did not identify any internal control weaknesses.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on compliance with SBLGP requirements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of BT&H, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

### ***Original signed by:***

David Botelho, CPA  
Chief, Office of State Audits and Evaluations  
(916) 322-2985

October 16, 2008

## FINDINGS AND RECOMMENDATIONS

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### **FINDING 1                      Untimely Remittance of \$15,750 in Recovered Funds Increases the Risk of Misappropriation or loss of the Funds**

Three of the seven remittances of recoveries were not made within the required timeframes as follows:

- A \$15,000 recovery remitted on December 19, 2006 was received by Pacific Coast on October 6, 2006.
- A \$500 recovery remitted on December 19, 2006 consisted of \$50 monthly payments received between September 15, 2005 and June 12, 2006.
- A \$250 recovery remitted on December 19, 2006 consisted of \$50 monthly payments received between July 3, 2006 and November 13, 2006.

Criteria:                      Small Business Loan Guarantee Contract Agreement, Exhibit D, Section 17 (D), states that all funds received by the contractor totaling \$10,000 or more pursuant to a guarantee default shall be remitted to the state within ten working days. The contract agreement also stipulates that funds totaling less than \$10,000, pursuant to the same guarantee default or payoff, shall be remitted to the state at least quarterly.

Recommendation:        Implement procedures to ensure that recoveries are timely remitted.

### **FINDING 2                      Loan Guarantee Program Database Has Not Been Updated for Recoveries since the Year 2000**

The Business Transportation and Housing Agency (BT&H) was not aware of the undeposited funds discussed in Finding 1 because the database was not updated. Therefore, BT&H was unable to monitor the remittance of these funds. The lack of updating the recoveries in the Loan Guarantee Program Database is a significant internal control weakness that increases the risk that loan recoveries could be misappropriated or fraud could occur without timely detection.

Criteria:                      According to the SBLGP Policies and Procedures Manual, Section III, page 27, information pertaining to any recoveries must be entered into the Loan Guarantee Program Database.

Recommendation:        Ensure that data from recovery funds is properly maintained to enable timely monitoring and proper crediting of recovery funds.





**Pacific Coast Regional**  
Small Business Development Corporation

Mark J. Robertson, Sr.  
President/Chief Executive Officer

November 19, 2008

David Botelho, Chief  
Office of State Audits and Evaluations  
Department of Finance  
300 Capital Mall, Suite 801  
Sacramento, CA 95814

Re: Response to Draft Report of October 2008 on  
Pacific Coast Regional Small Business Development Corporation  
Agreed-Upon Procedures

Dear Mr. Botelho:

In response to the "Findings" included in the above noted report I offer the following:

**Finding 1:** Untimely Remittance of \$15,750 in Recovered Funds Increases the Risk of Misappropriation or loss of the Funds.

**Response 1:** The finding is accurate and procedures have been implemented to avoid this occurrence going forward.

**Finding 2:** Loan Guarantee Database Has Not Been Updated for Recoveries since the Year 2000.

**Response 2:** This finding is also accurate, and staff now understands its necessity as a tool to avoid issues that could arise from "Finding 1" above. Since data input and remittances are (and should be) separate internal functions, current data is necessary as an internal audit control. Recovery data will now be entered on a monthly basis. It should be noted, however; that BT&H has been able to track Recoveries via the monthly trust statements from the trustee, but current data input will also allow them to investigate when funds are not timely remitted.

Please convey our appreciation to the review staff for their insight and guidance. We look forward to the same objective council in the future.

Yours truly,

Original signed by:

Mark J. Robertson, Sr.  
President/CEO